

# ICPS newsletter

## State budget: Depending on needs or capacities?

*The state budget should respond to the needs of society. But today there is no consensus on achieving a balance between social goals and the state's limited resources. Presidential contender Ms. Natalia Vitrenko believes that the budget is a tool for the complete satisfaction of the needs of society. In contrast, Mr. Janis Platais, ex-deputy of minister of finance of Latvia, IMF advisor at the State Treasury of Ukraine, is sure that first of all the state budget should reflect realistic possibilities and ensure stable economic growth. This problem, of reconciling the Ukrainian budget with societal needs and its capacities was discussed at a roundtable held jointly by ICPS and the Freedom of Choice Coalition*

According to Ms. Natalia Vitrenko, the budget should be planned with the aim of completely satisfying social needs. The minimum wage and minimum pension should cover all vital needs, and benefit and social security systems should be brought into line with social normatives.

But Mr. Janis Platais is confirmed that budget efficiency depends on following other principles:

- budget planning on the basis of capacities, not needs;
- availability of a clear and effective system of control over budget implementation;
- responsibility of spending units for the effective use of budget funds.

Ms. Vitrenko noted that the economic crisis would be overcome only if Ukraine denounced its agreement with the IMF and suspended payments on its external debt for three years. The freed surplus of funds would be allocated to reviving domestic production. \$40-million budget revenues would provide the opportunity to guarantee state orders for the products of agriculture and the coal industry. But Ms. Maryna Shapovalova, deputy head of the Central Budget Department of the Ministry of Finance, argued that it was necessary to put two questions honestly: who will allocate the

additional value, bureaucrats or the producers? and who should the state support, producers or consumers?

Ms. Vitrenko believes that budget deficit for 2000 should be 8 percent of GDP. Contrarily, Mr. Viktor Lysytsky, chief economic advisor to the head of the NBU, claimed that a budget deficit at the level of 8 percent of GDP in 2000 would mean a cash accretion of 10 billion hryvnias, leading to twofold price increases at least the following year.

According to Ms. Vitrenko, ways of increasing budget efficiency include moving from indirect taxes to direct ones, simplifying the tax system, and transferring the tax burden from producers to well-to-do consumers. A single profit (income) tax should be implemented, while the value-added tax should be abolished and replaced by a sales tax, which would replenish local budgets. But Mr. Valeri Asadchev, a people's deputy and member of the Verkhovna Rada Budget Committee, believes that in Ukraine, where on average 16 enterprises are involved in the production process, a turnover tax would destroy domestic production rather than protect it.

Mr. Platais thinks that the main function of the state budget should be to ensure stable economic growth, which is possible only under decreasing

### **This Week**

**"Ukraine's future: A plan for the President".** ICPS, jointly with the Freedom of Choice Coalition and the Coordination and Analysis Center for Ukrainian Business Associations has started the "Ukraine's future: A plan for the President" project. This project entails conducting a series of seminars to identify the main points of view regarding important economic policy issues, including:

- public administration and budget reform;
- reforming the education system: improving the quality of human capital;
- policies facilitating competition in the agricultural and energy sectors;
- reforming the social security system;
- development of small and medium business.

Discussion will promote an overall understanding on a development strategy for Ukraine.

The goal of the first seminar on "Public administration and budget reform", planned for November 3, is to reach an understanding on strategies necessary for reforming the public administration system and improving the budget process in Ukraine.

Presentations will be given by Mr. Oleksandr Paskhaver, president of the Center for economic Development in Kiev, Ms. Tetiana Sytnyk, ICPS economist, and Ms. Diana Cook, RAND advisor.

The second seminar on "Educational Reform: Improving the quality of

*human capital*" will be held on November 5, in order to work on proposals for strategy improving the education system in Ukraine.

Presentations will be given by Mr. Volodymyr Nikitin and Mr. Yuri Lukovenko, ICPS advisors, and Mr. Pavlo Khobzei, chief of the Board of Education of the Department for Humanitarian and Social Policy of the Lviv city council.

The following discussion issues are proposed:

1. Strategic goals for the development of Ukrainian society in general.
2. Role of the given sector in the long term (sectoral policy goals).
3. Sectoral problems and their causes.
4. Alternative solutions.
5. Short-term and medium-term consequences of these measures.
6. Strategy: obstacles, implementation plan.

### **Next Week**

**Improving the social security system.** The third seminar within the framework of the "Ukraine's future: A plan for the President" project will be devoted to the subject "Reforming the social security system". The goal of the seminar is to work out strategies which will identify:

- guidelines for reforming the social security system in Ukraine;
- obstacles to reform;
- approaches to overcoming such obstacles.

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*Concerning invitations for ICPS's seminars, please contact Larysa Romanenko, manager of the Communication Forums Group.  
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dependence on foreign and domestic loans to finance the budget deficit. The tax system should be based on the lowest possible tax rates and the widest possible taxation base. State expenditures will become more effective if they are allocated to financing those services that are most required by citizens.

Economic growth, in its turn, will be the source of budget revenues. This objective can be achieved, for example, through restructuring the economy, aiming at recovery or closure of enterprises which consume more resources than they produce.

Government policy should also support an optimal ratio between small businesses and large enterprises, particularly those with foreign capital that promote new technologies and open up new external markets for Ukrainian goods.

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*A roundtable with presidential contenders on "Freedom of choice: Does Ukraine's budget respond to the needs of society?" was held by ICPS and the Freedom of Choice Coalition on October 16, 1999.*

## Harvard proposes agenda for economic reforms

**Experts of the Harvard Institute for International Development (HIID) evaluated the key economic problems in Ukraine and developed their own recommendations regarding implementation of comprehensive post-election reforms. Mr. David Snelbecker and Mr. Edward Novoseletsky, HIID representatives, presented their research results at ICPS's macroeconomic seminar on October 26. The experts believe that there are two fundamental problems of the Ukrainian economy—the "supply" problem and the "demand" problem**

According to the HIID experts, there are two fundamental problems of the Ukrainian economy—the "supply" problem and the "demand" problem. On the supply side, the economy of Ukraine can be seen as comprised of two types of economic activity: there are those who produce goods and services, adding value to society (the producers), and there are those who seek to take value from others, rather than producing it themselves (the "rent-seekers"). Excessive numbers of constraints on producers and the ease of allocating value on the part of the state lead to less and less output volume, and more and more rent seeking.

The HIID experts believe that another problem, on the demand side, is that there are insufficient sources of demand for Ukrainian goods and services. Ukrainian households and enterprises

have few financial resources with which to buy domestic products. While increasing the demand of domestic consumers can only be a gradual process, foreign demand could be stimulated fairly rapidly through appropriate economic policies.

Guided by their conducted analysis, the HIID experts proposed to implement a comprehensive program of reforms in Ukraine, resting on four pillars:

- (a) supporting "new" market-oriented enterprises;
- (b) reforming "old" enterprises;
- (c) restructuring the budget sphere;
- (d) promoting an open economy.

*ICPS's macroeconomic seminar on "Potential of Comprehensive Reforms after the Presidential Elections in Ukraine" was held on October 26, 1999.*

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